

Disparity in Operations: Comparative Analysis of Small ILEC CHCF-A Carriers to Non-CHCF-A Carriers

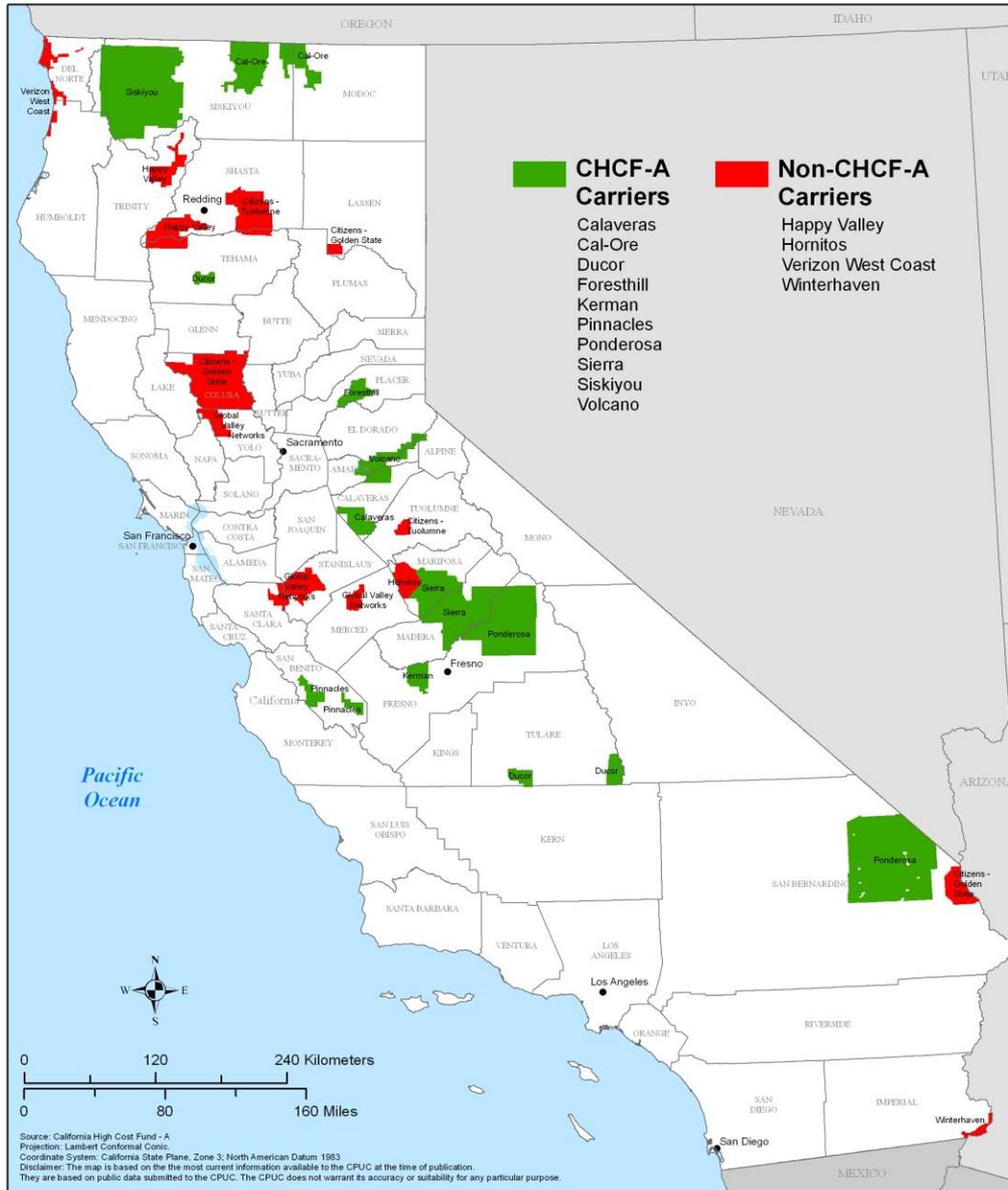
Communications Division

January 2010*

* Revised as of March 2011



SMALL ILEC SERVICE AREAS



- This study is of 17 small ILECs operating in California who were eligible to receive CHCF-A funding from 2003-2008.
- These carriers range in size from 200 to 23,000 access lines.
- In 2009, the number of eligible small ILECs decreased to 14.

Major Findings



- Gross Revenues per access line is **three to four times** higher for CHCF-A carriers than for Non-CHCF-A carriers for the years 2007 and 2008. Even after CHCF-A fund support is excluded, CHCF-A carriers still earned gross revenues per access line that is **two to three times** more than their Non-CHCF-A counterparts.
- Net income of CHCF-A carriers is **two to three times** more than their Non-CHCF-A counterparts, but when CHCF-A support is excluded from net income, CHCF-A companies net income becomes negative.
- In 2008, Operating Expenses of CHCF-A carriers were **three times** higher than Non-CHCF-A companies but in some previous periods the disparity was over **six times**.
 - CHCF-A carriers spending versus Non-CHCF-A carriers:
 - ◆ **five and one-half times** more on Corporate Operating expenses
 - ◆ **four times** more on Plant Specific expenses
 - ◆ **two times** more on Customer Operating expenses and Depreciation and Amortization
- Total Plant In Service spending for CHCF-A carriers between 2003 and 2008 is at least 134% more than Non-CHCF-A carriers for all components except Above Ground where Non-CHCF-A carriers spend more.
 - CHCF-A carriers spending versus Non-CHCF-A carriers:
 - ◆ **three times** more on TPIS: Land and Support
 - ◆ **one and one half times** more on TPIS: Cable and Wire
 - ◆ **three to four times** more on Net Average TPIS

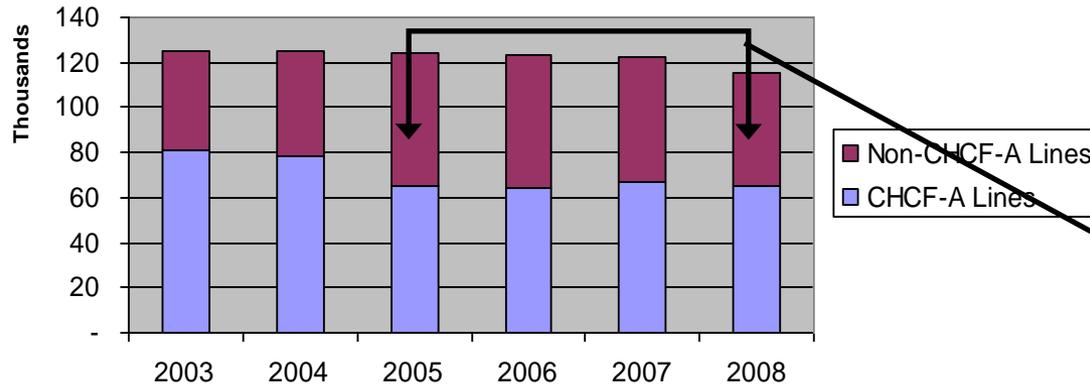
MAJOR FINDINGS



	CHCF-A Companies (Times greater than)	vs.	Non-CHCF-A Companies	Notes
Gross Revenues/Access Line (including CHCF-A fund support)	4	>	1	
Gross Revenues/Access Line, Less CHCF-A fund Support	3	>	1	
Net Income/Access Line (including CHCF-A fund support)	3	>	1	
Net Income/Access Line less CHCF-A fund support	Negative (<0)	<	Positive (>0)	Negative net income---> Operating expenses higher than revenues
Operating Expenses/Access Line	3	>	1	
TPIS Components: Land and Support	3	>	1	

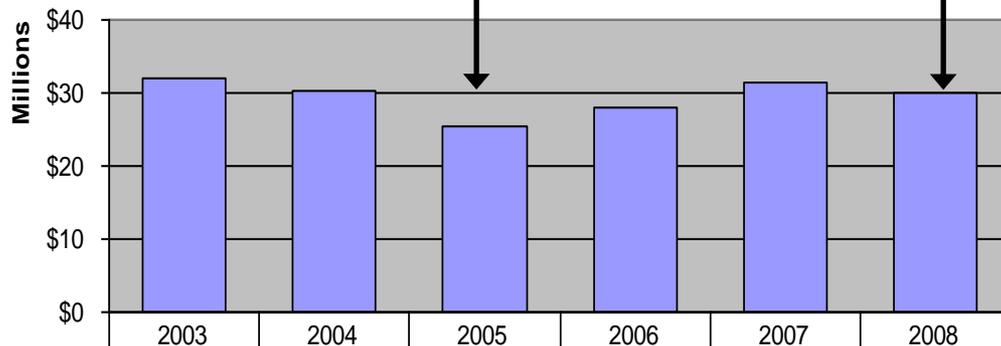


Total Access Lines for Small LECs

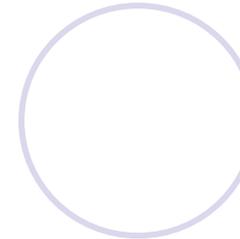
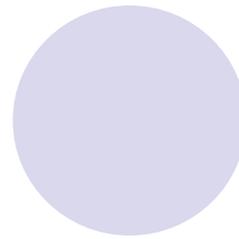
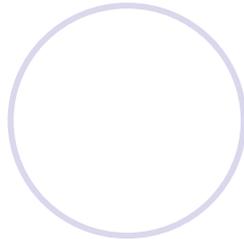
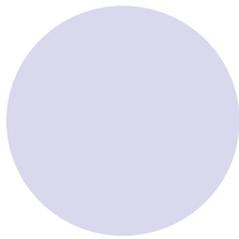


- The number of access lines receiving CHCF-A has decreased slightly since 2005.
- While CHCF-A funding has **increased** by 18% for that same time period.

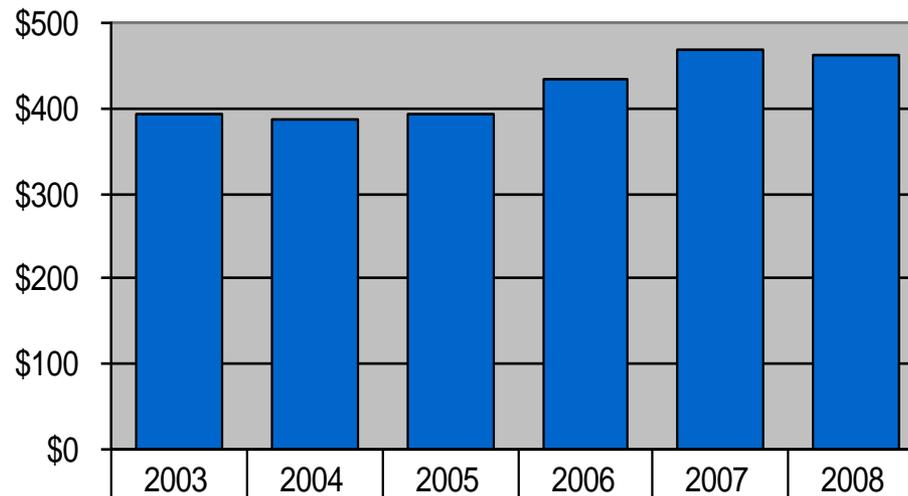
CHCF-A Funding



CHCF-A Funding	31,870,002	30,395,320	25,446,077	28,096,729	31,393,619	29,992,396
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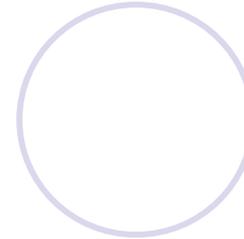
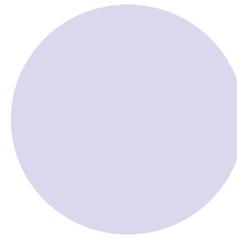
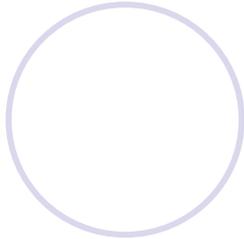
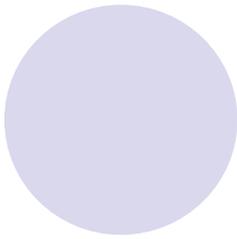


Annual CHCF-A Funding per Access Line

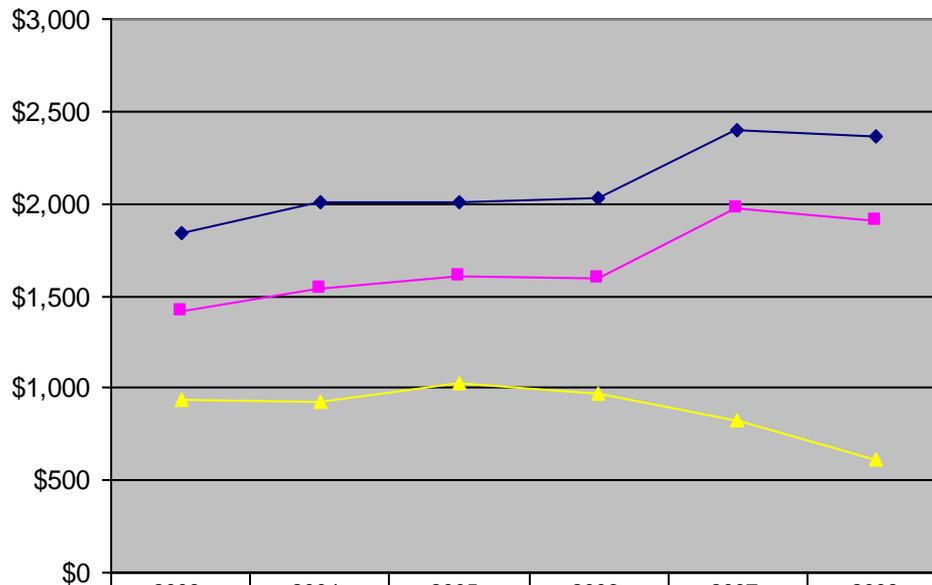


■ Annual CHCF-A funding per access line	\$392.84	\$387.12	\$393.01	\$435.21	\$470.08	\$462.49
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- Comparing 2008 to 2005, annual funding per access line has increased by **\$69.48** or over **17.6%**.
- In 2008, CHCF-A carriers received **\$38.54** per month per access line.

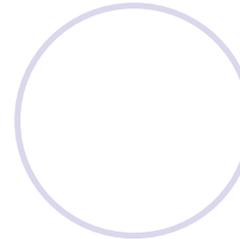
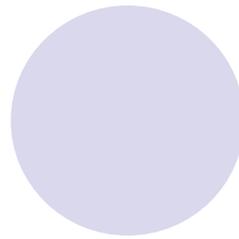
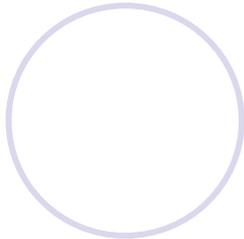
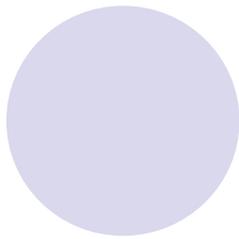


Gross Revenue Per Access Line

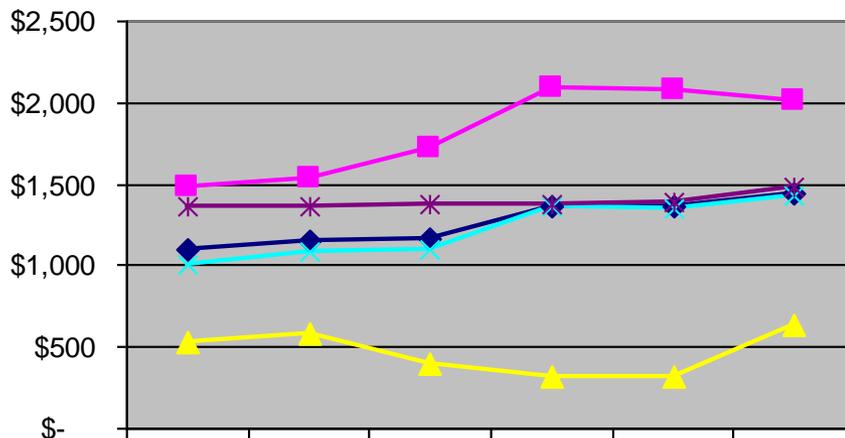


◆ CHCF-A Gross Revenue with CHCF-A Support	\$1,839	\$2,007	\$2,004	\$2,033	\$2,398	\$2,367
■ CHCF-A Gross Revenue Without CHCF-A Support	\$1,416	\$1,539	\$1,611	\$1,598	\$1,973	\$1,905
▲ Non CHCF-A Gross Revenue	\$933	\$923	\$1,025	\$973	\$830	\$612

- Gross Revenues per Access Line for CHCF-A carriers is nearly **four times** higher than Non-CHCF-A carriers.
- Without CHCF-A funding, it is over **three times** higher.



Average Operating Expenses Per Access Line



	2003	2004	2005	2006	2007	2008
◆ All Carriers	\$1,092	\$1,152	\$1,164	\$1,368	\$1,356	\$1,440
■ CHCF-A Carriers	\$1,488	\$1,536	\$1,716	\$2,088	\$2,076	\$2,004
▲ Non-CHCF-A Carriers	\$528	\$588	\$396	\$324	\$324	\$636
× Alpine Carriers	\$1,008	\$1,080	\$1,104	\$1,356	\$1,344	\$1,428
* Valley Carriers	\$1,368	\$1,368	\$1,380	\$1,380	\$1,392	\$1,476

- The operating expenses of CHCF-A carriers are **three times** greater than Non-CHCF-A carriers.
- The operating expense differential between Alpine and Valley carriers is negligible.





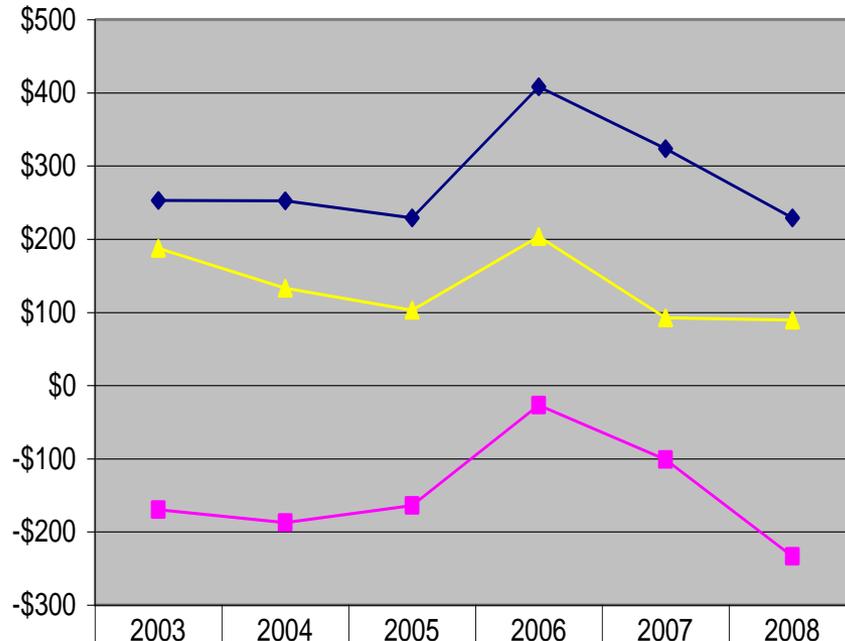
Average Operating Expense Components Per Access Line
 (Represents the percentage that CHCF-A carriers expense components per AL are higher than Non-CHCF-A carriers)

	2003	2004	2005	2006	2007	2008
Plant Specific Expense	425%	372%	361%	389%	384%	357%
Depreciation & Amortization Expense	221%	139%	208%	196%	277%	261%
Customer Operating Expense	216%	166%	144%	174%	180%	178%
Corporate Operating Expense	408%	329%	267%	417%	487%	550%
Total Operating Expense	281%	263%	434%	646%	638%	317%

- CHCF-A carriers are spending **144%** to **550%** more on operating expense components than Non-CHCF-A carriers
- The Operating Expense disparity has been more than **600%** in some years.



Net Income Per Access Line



◆ CHCF-A Net Income With CHCF-A	\$253	\$252	\$229	\$408	\$324	\$229
■ CHCF-A Net Income Without CHCF-A	-\$170	-\$187	-\$164	-\$27	-\$101	-\$234
▲ Non-CHCF-A Net Income	\$187	\$133	\$103	\$204	\$92	\$89

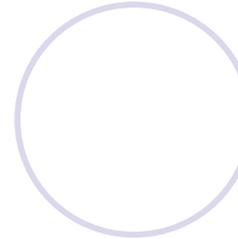
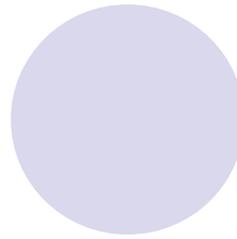
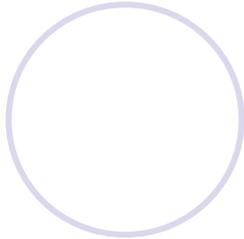
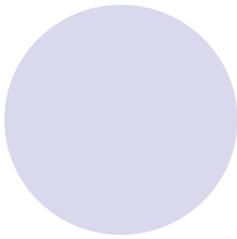
- Net income per Access Line for CHCF-A carriers is **two to three times** greater than that of Non-CHCF-A carriers.
- When CHCF-A support is excluded, the net income of CHCF-A carriers is **negative**. This suggests that CHCF-A carriers operating expense spending exceeds their revenues



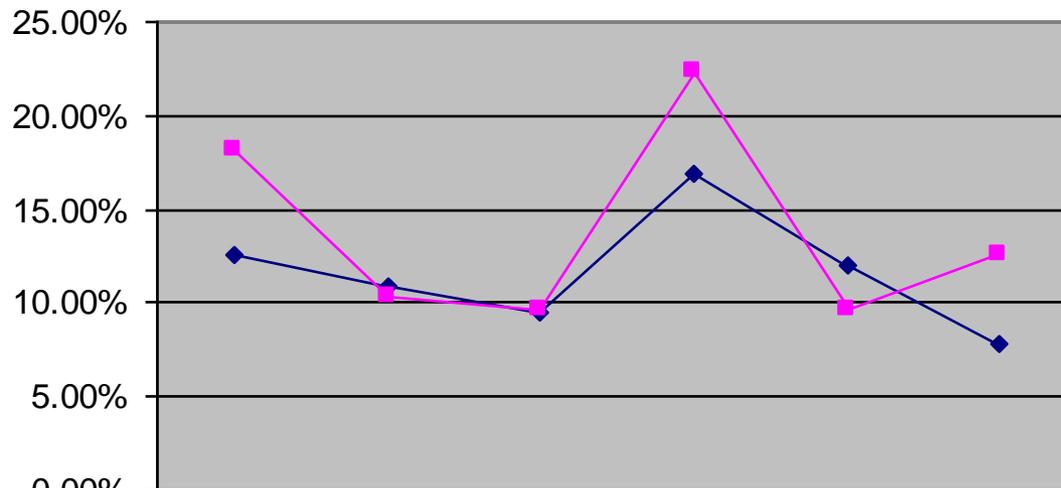
Total Plant in Service (TPIS) per Access Line
 (Represents the percentage that CHCF-A carriers TPIS per AL are higher than Non-CHCF-A carriers)

	2003	2004	2005	2006	2007	2008
TPIS Components:						
Land and Support	250%	262%	281%	279%	302%	291%
Central Office Switching	160%	165%	157%	143%	152%	134%
Transmission	161%	172%	186%	167%	170%	160%
Cable and Wire	146%	151%	158%	163%	185%	181%
Above Ground	71%	72%	72%	67%	66%	76%
Net Average TPIS	282%	267%	290%	376%	383%	330%

- CHCF-A carriers are spending **302%** more for Land and Support
- CHCF-A carriers are spending **185%** more for Cable and Wire
- CHCF-A carriers spend **76%** of what Non-CHCF-A carriers spend on Above Ground TPIS
- CHCF-A carriers Net TPIS has now reached **330%** more than Non-CHCF-A carriers



Rate of Return on Net Average TPIS CHCF-A versus Non-CHCF-A Carriers



	2003	2004	2005	2006	2007	2008
◆ CHCF-A	12.62%	10.89%	9.45%	16.87%	12.01%	7.86%
■ Non-CHCF-A	18.21%	10.27%	9.62%	22.32%	9.58%	12.56%

- Both carrier groups seem to be experiencing similarly timed ROR fluctuations
- But, Non-CHCF-A Carriers ROR fluctuations are more extreme
- On average Non-CHCF-A Carriers are achieving higher ROR

Findings and Recommendations



This study of CHCF-A carriers was conducted to determine whether there exists significant differences in the business conduct of CHCF-A and Non-CHCF-A carriers that may explain their increasingly higher draws from the CHCF-A fund. We find that although similarly situated there are considerable differences in the operations of these two carrier types.

Most notably, CHCF-A funded carriers are:

- Significantly outspending Non-CHCF-A carriers
- Incurring operating expenses and plant in service expenditures far higher than Non-CHCF-A carriers
- Generating greater gross revenues than non-CHCF-A carriers, but their higher expenses result in negative net revenues per access line when A-fund subsidization is removed.

Given the above findings, we recommend an Order Instituting Rulemaking (OIR) to further investigate why CHCF-A carrier operations are so different from Non-CHCF-A carriers. Opening an OIR to re-evaluate the A-fund and consider alternative vehicles that would more efficiently ensure universal service in the current telecommunications marketplace should be the objective.

Findings and Recommendations

(continued)



Alternative options to assess in an OIR may include one or more of the following models:

- Incentive-benchmark subsidy model – a subsidy in which carriers are awarded for efficiency in operations, enhanced market penetration of universal telephone services, and prudent capital investment.
- Consumer direct model – a subsidy in which the payments are paid directly to customers.
- Risk-sharing model – a subsidy in which business risks are shared between the shareholders and rate-payers in which, any non-regulated revenues generated from the investment of the CHCF-A fund subsidy mechanism (e.g. capital investments) are shared with the CHCF-A fund.
- Flat grant model – a subsidy providing a flat dollar amount per access line based on industry or similar carrier cost factors.
- Capped subsidy model – a fixed subsidy that is adjusted based on an industry specific indicator such as the telecommunications CPI.
- Total operations model – a subsidy wherein all communication services including telephone, broadband, VOIP, etc., are included for ratemaking purposes.

Definitions and Information



- **Access lines:** Unique telecommunications access points. One access line generally indicates one customer.
- **Alpine Carriers:** Carriers with a substantial part of their territory in the mountainous / foothill terrain. They included all carriers except those listed as Valley below.
- **Valley Carriers:** Carriers with substantial parts of their territory in non mountainous/mostly flat terrain. For the purpose of this study they were; Ducor, Global Valley, Kerman, and Winterhaven.
- **CHCF-A:** California High Cost Fund-A
- **CHCF-A Carriers:** Small Local Exchange Carriers (LECs) that receive CHCF-A subsidy funding. They include; Calaveras, Cal-Ore, Ducor, Foresthill, Kerman, Pinnacles, Ponderosa, Sierra, Siskiyou, and Volcano.
- **Non-CHCF-A carriers:** Happy Valley, Hornitos, Verizon WC, Winterhaven and Citizens-G, Citizens-T, and Global Valley which, in 2009, become part of Citizens California and are no longer Non-CHCF-A carriers.
- **Gross Revenues:** Local Revenues, Network Revenues, Long Distance, and Miscellaneous Revenues.
- **Net income:** Operating Revenues less Operating Expenses less Taxes and Interest.
- **Operating Expense Components:** Depreciations and Amortizations, (D&A), Plant Specifics, Customer Operations, and Corporate Operations.
- **Rate of Return (ROR):** Net income as a percentage of net average TPIS.
- **TPIS:** Telephone Plant In Service.
- **TPIS Components:** Land and Support, Central Office Switching, Transmission, Cable and Wire, Above Ground
- **Net Average TPIS:** average of beginning year TPIS and end of year TPIS.

Data Collection

- Carrier financial data was obtained from their reports as filed annually with the Commission
- CHCF-A and federal USF subsidy data were obtained from the Commission records.